ROYAL COMMISSION ON
CORPORATE CONCENTRATION

Presentation by

THE CANADIAN BANKERS' ASSOCIATION

December, 1975

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ROYAL COMMISSION ON CORPORATE CONCENTRATION

Presentation of The Canadian Bankers' Association
November, 1975

1. The Canadian chartered banks welcome the opportunity of making a presentation as a group to this important Commission. The subject is one which, in view of the central role we play in the Canadian economy and corporate structure, is of deep interest to us. It is also one which we believe has aroused much public misunderstanding through lack of impartial study and exposition. The efforts of the Commission to present the facts in an objective way will have our full support.

2. The present brief has been designed to deal with some general issues involving the whole banking industry. Some of the banks will be making submissions more closely related to their individual positions and the scope of the present brief has been established with that in mind.

OUTLINE OF CONTENTS

3. In approaching the subject before the Commission we have naturally been guided by the terms of reference. We have paid particular attention however to the part of the press release of June 24, 1974, that was addressed to financial institutions. The general contents of this brief deal primarily with the issues mentioned there.

4. For the guidance of the Commission in considering this presentation the following is the order of its arrangement:

Part I

SOME GENERAL OBSERVATIONS

The Present Corporate Environment
The Banks as Corporations

more

Part II

FACTUAL BACKGROUND

The Facts of Size
The Facts of Concentration

Part III

THE ISSUES OF SIZE AND CONCENTRATION

The Issue of Relations between Banks and other Corporations
The Issue of Relations between Banks and other Financial Institutions
The Issue of Concentration

Part I

SOME GENERAL OBSERVATIONS

5. The issue given the Commission for enquiry is an important one. We have felt that as an Association our most helpful contribution would be to present factual information about banking in the hope that this might assist the Commission. However, at the outset some brief reflections on the position of the corporation in modern society may be appropriate.

THE PRESENT CORPORATE ENVIRONMENT

6. Obviously any attempt to deal comprehensively in this brief presentation with the issues arising from the role of the corporation in modern society would be ill-chosen. Given the vast outpouring of literature on the subject in recent years it would also be unnecessary. We would only like to register two or three points.

7. First: the corporation is today as valid and viable a form of business organization as ever in the past. It is a unique device for assembling funds for capital investment, for bringing together personnel, materials and equipment under organized management, and for ensuring distribution of a final product or service. As a legal entity it answers many complex problems of contract and legal responsibility. Found almost universally

throughout the world today for a multiplicity of purposes, the corporation gives every promise of a continuing long life.

8. Second: the corporation may be suffering as much from its success as from any other cause. Even though largely a legal fiction, massive efforts have been expended to clothe the fiction with a very substantial personality, in order to gain and retain customer loyalty. As a result the corporation itself has tended to take on its own identity. This has had mixed results. While achieving the main purpose of creating an easily recognized image it has also obscured the basic and important reality that the corporation is simply an instrument for organizing the investment and efforts of people - men and women - for an economic objective. Without the people who own it, manage it, operate it and sell its products a corporation is nothing. Much of this has been lost sight of in pressure to establish the separate , "c o r p o r a t e" image, to the detriment of real understanding of the essentials of the matter.

9. By the same token the corporation has become vulnerable by its very success in providing the goods and services of our complex life style. Much of this could not be sustained without the large scale complex modern industrial corporation. But with increasing dependence on corporations has come increasing sensitivity to shortcomings in their performance. Just to pick one single example out of hundreds that could be given: at one time if a cake did not rise, the housewife blamed herself for having misread the recipe - now she blames the corporation that produced the cake mix she used.

10. The all-pervasive corporation can expect to be subject to all-pervasive criticism.

11. Third: The corporation has come under close scrutiny as a result of a change that is going on in attitudes towards the economic process. This change has not yet completely clarified, but it is typified by increasing concern for the limits of growth, for social issues, for the environment, for job satisfaction, for minority groups and for

other related questions. Preoccupation with these issues has led some elements of society to look on the economic process as being almost anti-social and the corporation has suffered in public acceptance accordingly.

12. It is extremely unfortunate that this polarization between the "economic" and the "social" has developed, because it is an unreal separation. In fact it can be said that the most basic problem in any society is daily physical survival, and the instruments for achieving this goal are collectively described as "the economy". The provision of the means for survival - food, clothing, shelter, etc. - is therefore probably the most basic social goal of all, and the economy is expected to meet it. It is easy to overlook this simple fact in modern complex society. In short, to survive as a society the people of Smiths Falls, Ontario, Kelowna, British Columbia and Carbonear, Newfoundland, - not to mention all the other inhabitants of Canada - must be able to purchase bread, milk, shoes, etc. as they need them. Only let the situation arise for a week when even one of these needs is not met and one sees how quickly an "economic" issue becomes a "social" issue.

13. This may be labouring an obvious point, but it is apparent that today the private economy appears to get very few marks for carrying out this function and on the whole for doing it very well. Rather what emerges now is concern for shortcomings which are normally not a part of the corporate calculation but are rapidly becoming so. For example, in the Summer, 1975 issue of Business and Society Review (an American periodical) in an article headed "How Social Activists see Business", the following subjects were listed in answer to a survey involving the question "Which four or five of the problems listed do you think large companies should work on especially hard": discrimination against minorities (58%); using up natural resources (54%); air pollution (45%); dishonest business practices (43%); discrimination against women (40%); problems of the cities (37%); water pollution (32%); and having a satisfying job (29%). It is equally revealing that some of the issues which an "economic" activist would have given top priority were below these in order

some far below. These included inflation (24%); electric power shortage (9%); shortage of gasoline and oil (5%); and crime and violence (at the bottom of the list) 1%.

14. This list is not cited as a means of disparaging its contents; on the contrary these are all questions of general concern today. It does demonstrate however that the social activist - whoever he or she may be nowadays - is looking at corporations from an entirely different point of view than the business community. Many of these viewpoints would be held by businessmen, but the priorities could be quite different from that of the above list.

15. Fourth: this brings us to a vital question - the dilemma of corporate response to these new influences. Obviously some change - perhaps a radical change - is taking place in the corporate environment. Surveys in the United States indicate that the public credibility of the business community has been declining in recent years. But how is the deeper significance of this change to be gauged? How does a corporation determine that a particular movement is genuine? If a conscious response is to be made, how great a response? On whose shoulders within the corporation should a decision of this importance rest? How far should responsibility be left with government to formulate policies in the general public interest which all corporations must then follow? What jeopardy do corporations risk in leaving issues as important as these to be settled by others, with the ultimate decision being imposed from outside?

16. These are some of the very valid reflections that are entertained by the "business" activist. Perhaps two factors emerge as the principal deterrents to action: first, the clear evidence that some of the pressure originates not from sources that genuinely want to see improvements in the present economic system but are fundamentally opposed to it and have found the corporation a useful target for attack; second, the lact of any general guidelines which ensure that a competitive advantage is not given the corporation which does nothing about social issues.

17. As to the first point, it must be agreed that it would be foolhardy to ignore the views of critics on the grounds that they reflect a different approach to society than one's own; the world's history is littered with examples of the folly of this error. On the other hand it is understandable that economic or social propositions emanating from such sources will be greeted with something less than warm enthusiasm. They must be treated with due regard to their origin and motivation, and are so treated. The least acceptable are writings which appear under the guise of academic studies, such as The Canadian Corporate Elite. The motivation of the author of this work, W. Clement, is so thinly veiled that even a friendly reviewer commented on it unfavourably in his introduction to the book.

18. As to the question of guidelines; even to mention this as a deterrent gives the impression of advancing an excuse. This interpretation would be unfair to the many corporations which of their own volition have undertaken new projects or found new directions for existing activities in recognition of the undoubted greater concern for the social order, the environment and the impact of the economic processes on them. But what is the position of the corporation to be in a highly competitive industry where coping with such an issue as for example air and water pollution involves heavy expenses and integration of programs with other businesses and public agencies? Virtue is its own reward up to a point, but if this burden is to fall on corporations then there must be assurance that it falls equitably, and that none escape its responsibility.

19. We are witnessing the evolution of a new framework of relationships between social expectations and social costs. Social expectations now call for a greater awareness of values that affect all individuals in all their various roles in life; meeting the resulting costs can have major consequences for our national economic arithmetic and possibly disastrous consequences for individual firms.

20. The extent to which expectations can be met and the basis on which the resulting costs are to be shared will be one of the crucial issues of the next decade. These are not issues that can be left to be resolved by the corporate community, because they go far beyond its scope of influence and authority. On the other hand to place full responsibility with government

would leave the corporation subject in the future to increasing regulation of its day-to-day operations, a trend which even now is continuing to develop. There is an obvious danger in this trend which could be costly to all.

21. Obviously this is more than a simple issue of conflict of motivation or objectives. Not to have economic progress is a defeatist attitude. Economic progress must go on at any level of expectations but most particularly with rising standards of expectation. Social progress achieved in recent years has largely been a dividend from a rising national income. The real issue is the achievement of such progress through the maintenance of vital and viable economic processes while at the same time meeting broader social goals that have an impact on the economy. We see this as an integral part of the challenge before the Commission.

THE BANKS AS CORPORATIONS

22. We carry on with some of the general aspects of banking that seem relevant to their status as business corporations. Generally the banks have a different set of problems and sensitivities than ordinary industrial corporations. Considering the vast scope and scale of their operations this is not surprising. At one end of the spectrum they are involved in large scale financing of major industrial and commercial projects both here and abroad. They are also required to implement policies of the monetary authorities calling for massive actions of constraint or stimulation affecting the economic life of the country. At the other end of the spectrum they are providing daily personal services of a fairly exacting and sensitive character to millions of Canadians in two thousand communities throughout Canada. This great diversity of scale, location, and expectations presents many challenges.

The Image of Size

23. The main dimensions of banking are so massive that they no doubt confuse the average person. There are few industries for which the figures come to such large totals, and there are few industries for which such masses of data are presented so regularly. Adding to this basic difficulty is the fact that frequently the figures for the whole industry are featured, whereas

the activities of no other corporations are treated on such a bulk basis. Finally there is the problem that public understanding of the financial system is not very great, and few people are versed in the interpretation of the data relating to it.

24. There is the related problem that the physical things that are visible about the banks are also on a large scale. For example, the banks, usually in conjunction with developers, responded to the growth in Canadian cities in the last quarter century and replaced dozens of antiquated office buildings in several Canadian cities with modern structures. These buildings are large because of the efficiencies of consolidation and the scarcity of down-town land. They bear the name of a bank, but the bank itself usually occupies only a small part of the building, the rest being leased out. Not only are these buildings large, but they are usually concentrated in one area, the financial section of the city, and there is an inevitable tendency to confuse the size of the building with the size of the bank.

25. There is also the problem that the public is likely to think of ten banks as representing ten interests (and of five large banks as representing five <u>large</u> interests). In fact, the banks probably represent the pooling of as large and diverse a group of interests as almost any Canadian corporation - indeed as almost any world corporation. Their shareholders number over 185,000; none of them owns more than ten percent of the stock of any bank and most own far less; collectively they are overwhelmingly Canadian. In a real sense they may be taken as a cross section of Canadian individuals, estates, trusts, pension, mutual and other funds, unincorporated entities and other corporations. Thus the banks exist to serve the public interest, that group of the public whose assets they have on deposit, that other group to whom they have loaned this money, another group who use their other services and finally, that significant group of Canadians who own them.

Instruments of Government Policy

26. A further chronic source of misunderstanding also arises from the fact that the banks are obliged to restrict credit or raise interest rates as a result of policy changes made by the monetary authorities. The

necessity for these actions is better appreciated now than a decade ago, but the role of the banks in this process is still a mystery for many people and can lead on occasion to uninformed and unjustified criticism due to conditions beyond the control of the banks.

Personal Services

27. Despite these handicaps associated with the image of size the public expects and generally receives an exceptionally high standard of personal service from the banks. It is our experience that the public holds the banks generally to be very special institutions, and expectations for standards of performance are very exacting. People in general appear to be quite sensitive about financial dealings. They react strongly to anything short of complete efficiency and take affront easily at minor shortcomings.

28. It would be false to pretend that the banks never fall short of these expectations, but surveys of public attitudes conducted by independent research organizations for the Association* indicate that the public is generally well satisfied with the service it gets from the banks.

29. Most towns of any size in Canada have a branch of one or more of the banks, and they are very much a part of the local scene. So much is this true that most Canadian adults will remember a bank branch along with other landmarks as a familiar fixture of their childhood.

30. Today the banks are becoming increasingly involved in the personal finances of many families. For example, many purchasers of homes and automobiles today arrange their financing through a chartered bank, and many individuals and families rely on their banks for

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* Banking in Canada - Research findings from several Consumer Attitude Studies conducted in 1971, 1973, 1974 and 1975; prepared for the Canadian Bankers' Association by Contemporary Research Centre Limited, July, 1975.

financial assistance to meet other important outlays.

31. This increasing involvement in the personal finance of thousands of Canadians has placed on the banks a responsibility for helping people to understand the principles and precepts of money management, a responsibility that has been accepted and implemented through educational programs administered either by individual banks or the Association.

32. It is characteristic too of the high expectations of the banks that at the very outset of the changing attitude towards the role of women in business and society the banks were expected to take the lead. As one of the largest employers of women (93,000 out of a total staff of 129,000 at October 31, 1975), the banks have readily accepted the challenge by expanding training and educational facilities and by planning more rewarding career paths for them. It is the opinion within the industry that this effort has already met with considerable success and has promise for even further development in the future.

33. To verify this view, in co-operation with the National Advisory Council on Women, a survey is now being made in the banks by Miss Marianne Bossen of Winnipeg, who carried out a pioneer study of the same type for the Royal Commission on the Status of Women. The results of this study will be published early in 1976, and we are confident that they will show that very substantial further progress has been made towards raising the status of women employees in the industry.

Bank Performance

34. At this point it would seem logical to give a lengthy and detailed description of the major role that banks play in the Canadian economy and society. However we have resisted this temptation. A great deal of information is presented about the banks in sources already available and there seems no need to burden the Commission with a repetition of it here. As part of this presentation we are including the latest annual Factbook of the Association*, containing

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* available on request

most of the significant data on the industry. We would also be pleased to furnish the Commission with any other information that might be relevant to its enquiry.

35. There are a few aspects of the current banking structure which we feel deserve some special attention because they relate to the issue of size, and we will mention these briefly. We have pointed out the disadvantages of image that come with the present scale of Canadian banking; it is essential that we also set forth the advantages in matters of real substance that arise from size.

International Trade

36. For a country as deeply committed to international trade as Canada it is essential to have a banking system that is able to finance large scale exports of our basic products, assemble financing packages for capital projects of massive size and provide trade information and foreign exchange services in our main markets. The large Canadian banks have been among the leading banks in the world in these activities.

Resource and Industry Development

37. Similarly, in a country still heavily dependent on large scale resource development and the allied industrial structure, financial institutions of the size of the Canadian banks are a great strength for internal economic growth. Much of the original and continuing financing of our resource and industrial development is done by the banks.

Social Needs

38. The Canadian banks are able to respond quickly to a social need requiring large-scale co-operation and substantial funding when an appeal is made by government or other sources. For example, although the banks are not persuaded that financing is the only cause or even the main cause of the housing problem in Canada, when an appeal was made for the provision of additional mortgage funds this past fall the banks gave a ready response. The banks were able to cooperate readily because of their ability to quickly assemble the necessary resources.

Regional Development

39. The changing frontier has been financed largely by the establishment of branches of the banks, as regional economies matured the surplus funds made available in established areas were loaned in new and developing areas. This has been largely the financial history of the westward expansion of the country. Today, as regional figures of banking operations indicate, this process is continuing with funds continuing to flow through the banks both eastward and westward from the more developed central regions. This allocation of available resources can best be achieved through large national institutions such as the Canadian banks.

Payment Systems - Past and Future

40. The size and national character of the Canadian banks has given Canada, considering its vast geographical territory, one of the most efficient payments systems in the world. It not only handles a daily flow of about 3-1/2 million cheques but during the recent Post Office strike, for example, it completed many transactions for its customers that would have been otherwise impossible.

41. For the future development of the electronic payments system the Canadian banks start with an enormous advantage over the American because of the existence of a highly efficient clearing and payments system within the banking structure. Much of the co-ordination that will have to be developed in the United States already exists in Canada.

Branch Network

42. One of the truly special features of the Canadian banks is the branch system. The 7000 branches throughout 2000 communities in Canada are a unique asset, not only for the banks but for Canada. Branches are constantly being called upon to provide assistance beyond their basic function of offering something like 100 banking services. They are frequently the only financial contact between a small centre and the larger world. As such they bring to the smallest community access to the full resources of the bank. The manager and his staff are often called upon for information about business opportunities and other aspects of their region. Branch managers are often the central

organizers of charitable and other endeavours within their communities. With the movement of managers and staff between branches there is a transference of new ideas and knowledge from one area to another. In the larger centres of course the big branch with its hundred or more employees is an integral and major operating unit of the bank. In all banks decentralization of decision making has given increasing authority to the local branch and the regional office. Generally only applications for loans of over $1 million now are referred to head offices. In some banks that amount is even higher, although in the smaller banks it is lower.

43. The branch system is an essential part of the Canadian financial structure that brings great advantages to Canada; it could only have been created by institutions as large as the Canadian banks.

Head Office Expertise

44. Supporting the branch structure is the expertise found in the regional and head offices of the banks. Men and women from several disciplines are now employed as specialists in all the various areas that are required to service the branches as well as in central functions unique to head office. This concentration of skills is made possible by the efficiency and economy of servicing many needs through one organization.

Summing Up

45. We have not attempted in the above to give any details of the actual functions being performed by the banks but rather we have stressed the advantages of size in carrying out certain of these functions. No doubt others could be mentioned, because this list is by no means exhaustive. In the end we probably can put the matter best by expressing our own conviction that it is to Canada's great advantage to be facing modern complex economic issues with a strong, soundly established, well managed and nationally integrated financial system, of which the banks are a major element. Economic issues are not only national in their scale, but most are also international, and require institutions that are able to marshal great resources of talent and money. This is the essential role played by the banks for Canada today.

Part 11

FACTUAL BACKGROUND

FACTS OF SIZE

46. Measuring the size of a bank is not as clear and simple a matter as might be assumed. In its function as an intermediary between depositors and borrowers a bank is largely in the position of administrating the funds of other individuals and businesses. The funds it receives become liabilities and the loans and investments it makes become assets, but in ordinary commercial terms these figures are much closer to volume of business measurements (e.g. gross sales) than they are to balance sheet data. For some types of comparison for example figures of net revenue or shareholder's equity or number of employees or number of business outlets or other information may be more relevant.

47. Nonetheless it is a general and internationally accepted standard to measure bank size by total assets. This also has validity for the Commission, since asset holdings are a reflection of the economic impact of the institution concerned. In Table I we give the latest available asset figures for the ten operating Canadian banks, and for whatever interest it may be to the Commission we also give the latest figures for the number of employees and branches in Canada.

Table 1

Selected Data on Canadian Chartered Banks

(Assets, Employees and Branches)
as at October 31, 1975

	Assets ($ mill)	% of Total	Canadian Employees	% of Total	Branches in Canada(1)	% of Total
Royal Bank of Canada	25,211	23.94	28,655	22.21	1,432	20.40
Canadian Imperial Bank of Commerce	22,259	21.14	27,855	21.59	1,660	23.65
Bank of Montreal	18,243	17.32	25,770	19.97	1,243	17.71
Bank of Nova Scotia	16,006	15.20	18,430	14.28	924	13.17
Toronto Dominion Bank	13,576	12.89	14,766	11.45	891	12.70
Bank Canadian National	4,872	4.63	7,304	5.66	479	6.82
Provincial Bank of Canada	3,059	2.91	4,573	3.55	324	4.62
Mercantile Bank of Canada	1,288	1.22	483	.37	12	.17
Bank of British Columbia	625	.59	888	.69	30	.43
Unity Bank of Canada	172	.16	303	.23	23	.33
TOTAL	105,311	100.00	129,027	100.00	7,018	100.00

(1) Foreign branches were 262 at the same date. The Canadian figures include sub-agencies in Canada.

48. For many people, and this would include many bankers, the fact that total assets of the system passed the $100 billion mark in 1975 is a startling phenomenon. This is an increase of two hundred per cent from 1967. Put even more dramatically, assets of the Canadian chartered banks have grown as much in the last five years as they did in the previous century. A growth of this magnitude is explained primarily by three causes: (1) increase in Canadian dollar assets due to domestic financial and economic developments; (2) growth of foreign currency assets and (3) the effects of inflation. Basic to this growth of course has been the trust of the public in Canada's banking institutions.

49. In Table 2 below figures for Total Assets, Canadian Dollar Assets and Foreign Currency Assets are given for the years 1967 to 1974 and for the latest month in 1975.

TABLE 2

Canadian Dollar and Foreign Currency Assets
(millions of dollars

End of Period	Canadian Dollar Assets	Foreign Currency Assets	Total	Foreign Currency Assets as % of Total
1967	25,199	6,470	31,669	20.4
1968	28,940	7,806	36,746	21.2
1969	31,000	11,632	42,632	27.3
1970	33,616	13,691	47,307	28.9
1971	39,958	14,469	54,428	26.5
1972	46,650	16,572	63,222	26.2
1973	56,455	23,298	79,754	29.2
1974	68,506	28,509	97,015	29.3
1975 (Oct.)	74,539	30,772	105,311	29.2

Source: Bank of Canada Review, Table 7

Canadian Dollar Assets

50. The principal domestic influences bringing about an increase in Canadian dollar assets have been the rise in the money supply and economic growth, both affected in dollar terms by the accelerating influence of inflation in the last two years. Table 3 below compares rates of growth in major Canadian dollar assets with money supply and gross national product. There are fairly close parallels between several significant series.

TABLE 3

Financial and Economic Factors affecting Bank Asset Growth
(index with 1967:100)

	Banks' Canadian $ Major Assets	Money Supply			GNP
		Currency and Total Can. $ Deposits	Currency and Privately Held Can. $ Deposits	Currency and Can.$ Demand Deposits	
	%	%	%	%	%
1967	100.0	100.0	100.0	100.0	100.0
1968	112.8	112.6	113.4	104.3	109.3
1969	125.6	124.0	124.3	112.0	120.2
1970	132.2	130.4	131.1	114.6	129.1
1971	152.7	152.0	150.0	129.3	140.8
1972	182.2	177.5	176.4	147.4	156.6
1973	213.3	203.2	200.0	168.6	181.5
1974	255.7	239.6	240.0	184.8	212.4

Source: Based on Bank of Canada Review, November 1975, Table 1

Foreign Currency Assets

51. The ability of the Canadian banks to compete in the international arena because of their size and their innovative approach in recent years to foreign currency operations accounts for the fact that assets in this category have risen even more sharply than Canadian dollar assets. In 1975, as shown in Table 2, foreign currency assets increased nearly 400% from the level of 1967, as compared with 200% for Canadian dollar assets. In that period foreign currency assets have increased from 20% of the total assets to about 29%.

Growth of Non-Bank Financial Intermediaries

52. The foregoing data on growth would be less impressive if it appeared that the banks had forged ahead at the expense of retarded development for their competitors. In actual fact just the opposite situation has prevailed. Far from having a monopoly position over banking in Canada the share of the business held by the banks has been declining for some time. Many other institutions are now in the banking business besides the banks. The result is that about one-third of the business is now carried on by organizations not officially called banks.

53. This statement requires explanation. There are various concepts of banking, and different definitions are used in different contexts. However, the most generally accepted day-to-day concept is the receiving of deposits and the making of loans. The average person knows that this is the business or organizations known as banks, but it is also the business of many other entities not called banks. These are the trust companies, mortgage loan companies, credit unions and caisses populaires and other financial institutions. In number they total over 4,250 and the largest group being about 4,100 credit unions and caisses populaires.

54. The share of banking, as measured by Canadian dollar assets held by these other deposit receiving financial institutions, is now approaching one-third. This growth has taken place mainly in the post-war period, holdings of Canadian assets having risen from under 12% of the total in 1950 to 31-32% in recent

years.

55. Further evidence of comparative rates of growth in recent years is provided in Table 4 below, in which Canadian dollar assets of banks, trust companies, credit unions and caisses populaires are shown as an index based on 1967.

TABLE 4

Canadian Dollar Assets of Principal Deposit-Receiving Institutions
(1967 : 100)

End of Period	Banks	Trust Co's.	Mortgage Loan Co's	Credit Unions & Caisses Populaires
1967	100.0	100.0	100.0	100.0
1968	114.8	114.4	107.4	111.1
1969	123.0	132.6	118.8	121.3
1970	133.4	150.8	136.3	135.1
1971	158.6	171.6	150.0	163.6
1972	185.1	197.6	172.4	208.2
1973	224.0	241.4	213.3	260.6
1974	271.8	285.8	243.3	305.0

Source: Bank of Canada Review, November, 1975: Tables 7, 39, 40, and 41.

56. The above comparison shows the position of the banks among deposit-receiving institutions. Even more significant is the estimate of the banks' holding of Canadian assets in relation to the similar holdings of all financial intermediaries, (as compared with only deposit-receiving intermediaries). In recent years this share has fallen below 30%; this compares with 42% in 1950, 50-60% immediately before World War 1 and 75% at Confederation. While the banks are still the largest single holders of Canadian assets, there are other large and growing elements in the total picture. (This information is derived from E.P. Neufeld, The Financial System of Canada, Statistical Appendix.)

57. The conclusion that emerges is that most of the data normally used to demonstrate the size and dominance of the chartered banks can be misunderstood. Even among deposit-receiving institutions other

elements now represent approximately one-third of the total. Large as they appear to be the position of the chartered banks in the Canadian financial scene scales down considerably when viewed in this perspective.

Allocation of Bank Assets

58. For a Royal Commission concerned with the exercise of corporate power a brief look at the way in which bank assets are allocated would seem appropriate. This will demonstrate that a considerable proportion of their assets are allocated to governmental and other requirements. At the end of July Canadian assets were just over $72 billion. Of this total about 28% can be identified as being held either to meet mandatory government requirements, to comply with government legislation or to assist governments with their financing needs.

59. The following figures show the impact of these various factors at July 31, 1975.

	($billion)	(%)
Bank of Canada - cash & secondary reserve -	7.1	9.8
Government of Canada bonds-	4.3	6.0
Government of Canada guaranteed programs - (N.H.A.; F.I.L.A.; Student loans; H.I.L.; S.B.L.A.)	4.8	6.7
Loans to Municipalities	1.6	2.2
Canadian securities (prov. & mun. gov'ts.)	1.2	1.7
Wheat Board advance -	1.0	1.4
Total of above	20.0	27.8

60. This is a very minimal reckoning of the extent to which the banking system is involved in meeting government requirements or needs. In addition there are many other areas having high social or economic priority, where both by tradition and business custom there is such a firm expectation of bank financing that the banks have very little option in the matter.

How big is a Big Bank?

61. We have been presenting data on the relative size of the chartered banks as a group in the whole Canadian banking and financial system. However, this does not provide any basis for assessing the size of individual units within the group. For this purpose

a reasonable standard of comparison is between asset size of these units and asset size of banks in other countries.

62. As we stated earlier, asset size is accepted as a reasonable basis for comparing the size of banks. It is a basis that is not without its shortcomings, however. The scope of the banking function - even the so-called commercial banking function - is not identical between countries; some banking systems have concentrated more heavily on certain services or have a greater range of legal powers than other systems.

63. However such comparisons are compiled and published by responsible sources, and if used with allowance for the lack of exact comparability in banking systems give fairly reliable indications.

64. The most complete recent compilation available is one which appears in the June, 1975, issue of The Banker, published in London. In a rating of the 300 largest banks of the world on the basis of size of assets (converted to U.S. dollars) for bank years ending in 1974 the following facts emerge:

1. The two largest banks of the world, Bank America Corporation and Citicorp, both in the United States, at $58.7 billion and $55.5 billion respectively, are two and one-half to four times the size of any of the five largest Canadian banks.

2. There are 22 banks in the world larger than the largest Canadian bank, 30 larger than the second largest and 36 larger than the third.

3. Compared to our largest bank there are six banks larger in the United States, five in Japan, four in the United Kingdom, three in France and five in other EEC countries.

4. The five largest Canadian banks are among the 62 largest banks in the world.

FACTS OF CONCENTRATION

65. As an introduction to a review of the facts of concentration in Canadian banking the following quotation from the Interim Report on Competition Policy

of the Economic Council of Canada (July 1969) is useful: -

> "The level of concentration - the extent to which a small number of firms account for the bulk of an industry's out-put - has an important bearing on the state of competition in an industry. Where concentration is high, so too are the risks of strong market power, low competitive pressure, inefficiency and poor resource allocation. One must be careful however not to be overly simplistic and to translate measures of concentration into indexes of market power, for concentration is only one of the variables helping to produce these undesirable conditions." (P.79)

66. On the record is the fact that the data for the Canadian chartered banks shows that the five largest banks have over 90% of the assets of the industry. In the immediately following pages we attempt to distinguish between fact and appearance as to the real position of the chartered banks among their competitors and examine in some detail the historical developments leading up to the present status. We return to an appraisal of conditions of competition in the banking system of Canada in the light of the Commission's enquiry in a later section.

The Historical Background

67. The origins of the present status are not irrelevant to the Commission's enquiry, since it has not come about by accident. In fact it could almost be said to have come about as a matter of government policy.

68. The history of Canadian banking, like much else in Canadian history, was largely a matter of extending financial services westward from beginnings in the Atlantic Provinces and Quebec as the population expanded and the economy developed. This was a process in which there were never a great number of banks in existence, a situation no doubt attributable in part to the deliberate decision to keep banking under exclusive control of the national government, as contrasted with the American situation under which every state could incorporate banks. At Confederation some 35 banks were in operation. This number rose to 51 in 1874 on the

crest of a wave of over-optimistic expansion and the number declined in following years. The number stabilized around 35-37 by the late 1890's, but from that point onward it dropped more rapidly both as a result of failures and mergers. While there were ten insolvencies between 1890 and 1913, mergers accounted for a greater number of disappearances. Mainly as a result of new merger provisions in the Bank Act amendments of 1900 which permitted authorization by Governor in Council rather than by Parliament, there followed a period of consolidation and 17 mergers had taken place by the outbreak of World War 1. Another 11 mergers followed in the next decade, (some of them very important) and, along with additional failures, the total number of banks had come down to 10 by 1928. The Home Bank failure of 1923 was the last for any Canadian bank.

69. All this may be summed up as follows:- in the period 1874 to 1928 there were 51 banks in operation at the beginning, an additional 18 came into operation, 27 became insolvent and 32 merged with other banks leaving ten in operation in 1928.

70. Fewer incorporations or mergers have taken place since then, although those that have occurred have been important. The newly incorporated were Barclays Bank (Canada) (1929); Mercantile Bank (1953); Bank of British Columbia (1968): Banque Populaire (1969); Unity Bank of Canada (1973); and Canadian Commercial and Industrial Bank (1975). The Bank of Western Canada was also incorporated in 1966 but did not come into operation. The mergers were Barclays Bank and Imperial Bank of Canada; The Bank of Toronto and the Dominion Bank; The Imperial Bank of Canada and the Canadian Bank of Commerce; Banque Populaire and the Provincial Bank of Canada.

71. The most recent developments are the measures to incorporate IAC as a bank to be known as the Continental Bank of Canada and to establish the Northland Bank which is sponsored by the Western Credit unions.

Mergers and Government Policy

72. It is a very relevant fact in the whole history of Canadian banking that a merger between banks was prohibited except with the permission of the

Governor in Council. In a very real sense, therefore, the present position of the Canadian banking industry is the result of Government policy as reflected from time to time throughout our history. The Minister of Finance, as the government spokesman on specific mergers, was frequently called on to justify this policy. The reason given for permitting a merger varied with individual cases, but have been summarized broadly as follows: on the part of the selling bank, as impending insolvency, high costs, inefficiency of management, inability of small banks to exploit economies of scale and diversification of asset holdings; on the part of the purchasing bank, primarily the desire to penetrate markets and achieve economies of scale. The Economics of the Canadian Financial System - (D.E. Bond & R.A. Shearer, p. 261).

73. There is ample evidence that mergers were not approved lightly by the federal government, and that there had to be good reason in the public interest for each of them. In reviewing the historical development in 1929, after the merger movement was almost completed, a noted banking authority, B.H. Beckhard, concluded: "Generally speaking, the Canadian Government does not look with favour upon mergers unless they are urgently necessary to protect the depositors or stockholders from loss. Its policy very definitely is not to grant permission if the purpose is one of reducing competition." (The Banking System of Canada, 1929, page 343.)

Results of Policy on Mergers

74. The most direct and revealing result of the historical development of chartered banks in Canada is that the present position of dominance of five banks is not a new fact at all. It is indeed a very old fact. Our analysis shows that the present situation has prevailed with minor variations for the past half century. The share of assets of the banks that were the five largest at the time has been in the 80-90% range since the late twenties. Furthermore, throughout the same period there have been ten banks, give or take one or two.

75. In short, during a half-century of Canada's most dramatic economic growth, in which the banks took a central role, the total number of banks has been substantially the same as today and the role of five of those banks has also been about the same as it is today.

PART III

THE ISSUES BEFORE THE COMMISSION

76. In the balance of this presentation we deal with the three main areas on which the Commission through its press release asked for special comment from the financial institutions.

77. In this section the issues relating to size and concentration have been dealt with last, since they seem to us to require treatment in greatest depth. We therefore now address ourselves to the other two headings.

RELATIONS BETWEEN BANKS AND OTHER CORPORATIONS

Legal Restrictions

78. Ownership of other Corporations - A Canadian bank is prohibited from owning more than 10% of the voting shares of another Canadian corporation except where the amount paid by the bank for the voting shares is \$5 million or less, in which case ownership may be 50% of voting shares.

79. It should be noted that in our brief on the revision of the Bank Act submitted to the Minister of Finance we have recommended an increase in this limit to \$10 million in order to provide greater leeway for assisting newly established businesses.

80. An exception to these restrictions is made for a "bank service corporation". The essential characteristics of a "bank service corporation" are that it is a corporation "owning or leasing real or immoveable property held for the actual use and occupancy of the bank and the management of its business", or a corporation "engaging in the business of providing a service incidental or ancillary to, or used in the carrying on of, the business of the bank ---". (Bank Act, Section 76(8)).

81. Common Directors with other Canadian Corporations- there are specific restrictions on the appointment of directors from other companies to the board of a bank. Under the Bank Act no director of another corporation may be appointed a bank director when one-fifth or more of the directors of that corporation are already

on the board of the bank; (Sec. 18(7)).

82. Approval of Loans where Director has an interest - Under the Bank Act a bank director must absent himself from a board meeting during the time when the board is considering a loan or advance to himself or a firm of which he is a member or a corporation of which he is a director; (Sec. 75(5)).

83. These legal restrictions represent a quite different posture than found in many other countries of the world - notably Germany, France, Japan, Belgium and the Netherlands - where close association between the banks and industrial corporations has been encouraged, rather than the reverse. In making this comment we are not suggesting that we oppose the present Canadian arrangements, but only registering the fact that there are a variety of approaches to the rules governing these relations.

Ownership of Canadian Banks

84. In addition to the above there are some special rules governing the ownership of Canadian banks by others, which are of great importance.

85. General Restrictions - no one person (individual, corporation, etc.), and no group of associated persons may own more than 10% of the shares of a chartered bank. (Bank Act, Section 53)

86. Governments - Governments are effectively debarred from owning shares of a bank by a prohibition on the banks from transferring shares to governments or accepting share subscriptions from government. (Bank Act, Section 53) (although an important exception is granted for a government fund "established to provide compensation, hospitalization, medical care, annuity, pension or similar benefits ---").

87. Non-Residents - non-residents may not own more than 25% in total of the shares of a chartered bank. (Bank Act, Section 53)

88. As a result of these legal restrictions and efforts of the banks to ensure broad distribution of their shares apart from a few block holdings Canadian bank shares are widely owned, and principally by Canadian residents.

89. In 1974, of 185,000 shareholders 174,600 or 90% had Canadian addresses. Another 3% were resident in the rest of the Commonwealth and 2% were resident in the United States. The trend over recent years has been toward increasing participation of Canadian residents, their share of ownership having risen from 86% a decade ago.

Issues

90. One of the aspects of inter-business financial relations that must be addressed is the size syndrome - the illusion that bigness sees only bigness. In the banking context this implies that big banks only lend to other big businesses. It is probably unfair to take advantage of a statement so obviously naive, but the following is a demonstration of the sort of ideas that come to light on this score:-

> "A strong explanation of why capital is difficult to secure for new ventures not undertaken by members of the elite is that banking circles are so much a part of the established dominant corporate world making it almost impossible for outsiders to 'break in'. The economic elite has both contacts and legitimacy required for access to capital. Access to banks and insurance companies provides the advantage necessary to avail themselves of new investment opportunities. A tight system insures that investments by banks will be fairly stable and secure but at the same time prohibits those outside the small charmed circle from breaking into the elite. For this reason, it is argued that the banks with their extensive contacts in the economic elite provide the focal point for elite continuity and operate as a major exclusion mechanism." (The Canadian Corporate Elite - Clement - p.158)

91. Against this entirely unsupported and sweeping generalization the following facts must be placed:-

Bank Credit to Large Corporations - the sort of corporations that are in issue are obviously the largest - the corporations that as a group account in some businesses

for two-thirds or three-quarters or more of the volume. Their authorized lines of credit would fall into the top category of analysis made of business loans by the Bank of Canada. (Monthly Review, Table 10 of each issue and Table A3 of November,1974). The official data shows that actual loans under this category at the end of 1974 were only 38% of total business loans in amount and only .4% in number. On the broader measures of percentage of Canadian currency assets and total assets such loans represented 11.4% and 8.0% respectively.

92. Bank Credit to Small Corporations and Businesses - the same data shows that the category of smallest loans to businesses - less than $200,000 - accounted for 93% of business loans by number and 21% by amount. It is indicative of the attention paid to small businesses that there were 276,000 loans outstanding in this category at September 30, 1974, for an average amount of approximately $15,400. The total of 276,000 includes many non-incorporated businesses, but as a rough measure is twice the number of corporations that reported a profit for federal income tax in 1972, the last year for which figures are available.

93. The above data effectively denies the allegation that small and independent businesses are denied access to bank financing because they are not part of the "charmed circle of the elite". There is no data compiled that would support a reliable statement as to the proportion of such bank financing that represented start-up funds, but with as many as 276,000 individual business loans under $200,000 undoubtedly some of this money would have gone to beginners. Some indirect evidence, which we would not claim to be at all conclusive, is contained in the following quotation from a paper presented by John E. Bulloch, President, Canadian Federation of Independent Business, at the Canadian Conference on Banking (September, 1974) in which he presented the results of a survey of his members:-

> "In order to measure members' attitudes to the banks in general as compared to other potential sources of equity funding, members were asked whether they would prefer to deal with the Industrial Development Bank, the chartered banks, provincial lending institutions or other agencies. A significant 66.38% of the respondents preferred to deal with the chartered banks, 14.42% preferred to deal with the Industrial Development Bank; 6.13% preferred provincial agencies and 2.83% preferred other agencies."

94. Granted that this statement was accompanied by some critical comment on the role played by banks in providing equity funding at least it demonstrates that the preference of the small and independent businessmen would be for dealing with the banks by a considerable margin over the other sources mentioned.

95. It must be admitted that the whole area of venture capital still raises far too many questions for which there are no satisfactory answers. Several public and private organizations have been established to provide assistance in this area, including among them subsidiaries of or special functions established by the banks. A common complaint of these lenders is the infrequency with which they encounter a viable project or have one presented to them. Less viable projects now can turn to several sources of government funds, but even this does not appear to be the final answer. In this connection the conclusions stated in a Background Paper on <u>Small Business Finance in the Atlantic Region</u> by the Atlantic Provinces Economic Council in October, 1974, seem very relevant:-

> "This survey of small business financing in the Atlantic region indicates that the lack of availability of financing is not the basic problem. The analysis shows that established firms are obtaining financing from commercial institutions and that a proliferation of government agencies exists to meet needs that the commercial agencies consider too risky. Indeed, there is evidence that the existance of these government agencies has lessened the willingness that banks, etc., previously exercised in making loans: the "if govern-

> ment guarantees are available why not insist on them?" idea.
> What does emerge from the analysis is the high risk nature of loans to small businesses. This high risk element arises primarily from three factors:
> 1. lack of equity
> 2. lack of markets
> 3. lack of management ability
>
> Consequently efforts to improve the flow of financing for small business should be directed to these shortcomings."

96. It is not necessary to go any further into this complex subject for present purposes. Bankers have on several occasions dealt with their concerns for smaller businesses, since their problems are raised frequently and in a variety of contexts.

97. The main reason for introducing the subject here has been to reject the inference that because the banks have large corporate customers these are the only customers that are important to them. In fact the branches of the banks scattered throughout the communities of the country are in themselves very much akin to small businesses, and in each community the bulk of their business customers by the very nature of the structure of the economy, are small businesses.

98. We would like to take this opportunity to combat what amounts to suggestions of irresponsible actions by the banks in another area (with apologies to the Commission for being thus tedious). These arise in the publication Vancouver Limited, by Donald Gutstein. There is very little in this publication that could be accepted without reservation, but we take particular exception to the following completely misleading statements:-

> "The banks have taken hundreds of millions of dollars - the savings of countless Canadians - and tied them up in concrete and glass, instead of investing the money in something really needed by those same Canadians such as low-cost housing." (p.28)

> "Did you ever wonder what happened to the money you deposited in your bank account? Some of it may have been loaned to a foreign

government to build better roads, so that its troops could be moved around the country more quickly." (p.184)

99. The first statement ignores the fact that like other corporations the banks have shareholders, and that investment in buildings are for their account, not for depositors; furthermore that the $7 billion the banks have invested in residential mortgages is out of the savings of Canadians. The second statement reflects the assumption, all too common, that Canadian banks use funds gathered in Canada for investment abroad. This is simply not the case. Funds invested outside Canada are obtained in foreign currencies through international money markets.

RELATIONS BETWEEN BANKS AND OTHER FINANCIAL INSTITUTIONS

100. There are several legal restrictions on relations between banks and other financial institutions in the Bank Act. They are summarized below.

Legal Restrictions

Other Banks

101. Purchase of Assets and Amalgamation - since 1900 purchase of assets of another bank and amalgamation of two or more banks has required the permission of the Governor in Council. (Secs. 99-102)

102. Ownership of Shares - no chartered bank may own shares of another chartered bank, nor "deal in or lend money or make advances upon the security of shares of the capital stock of the bank of any other bank". (Sec.75(2)(c))

103. Directors of Other Banks - no director of a bank may be appointed as a director of another bank. (Sec. 18(5))

Other Financial Institutions

104. Ownership of Shares - a Canadian bank is prohibited from owning more than 10% of the voting shares of a Canadian trust or loan company that accepts deposits. (Sec.75(1))

105. Directors of other Financial Institutions - no director of a bank under the Quebec Savings Bank Act or of a trust or loan company that accepts deposits may be appointed a director of a bank. (Sec.18(6))

106. Placing of Insurance - an ancillary restriction in the Bank Act prohibits any officer or employee of a bank from acting as an agent for any insurance company or for any person in the placing of insurance. (Sec.75(6))

Issues

107. Thanks to the historical development of functions in the Canadian financial system we see few issues that would concern the Commission in relations between the banks and other financial institutions. However, there are two or three matters we would like to mention.

Conflicts of Interest

108. One of the most serious conflicts of interest in our view, which we have so far avoided in Canada, arises where financial institutions perform both a financing and fiduciary function. This occurs where, as with the U.S. banks, both banking and trust services are performed by the same organization. As an industry we are opposed to the introduction of this sort of conflict into the Canadian system and have made a representation to the Minister of Finance to that effect in our brief on the Bank Act, as follows:-

> "There have been suggestions from a number of sources in recent years that at this revision the banks would ask for full trust powers, either immediately or on a delayed basis, concurrent with the granting of wider powers to trust companies.
>
> The banks gave serious study to this question in 1965, when the matter was discussed during the Porter Commission hearings, and individual banks have considered it since then. Having in mind the experience in other countries, particularly in the United States, we have come to the conclusion that there is a serious danger of conflict of interest for the banks in this proposal. This would arise

> particularly from their involvement in commercial lending to corporations whose securities are traded in the public markets and concurrent responsibilities in the discretionary management of the financial assets of third parties. For the same reason we question that the chartered banks should get into the fiduciary estate trust and portfolio management businesses where full discretion would be in the hands of the bank."

Payments Systems

109. An issue that is of limited consequence at the moment but will be receiving greater attention in the future is the relationship between the banks and the non-bank financial institutions in electronic funds transfer systems. However the whole range of legal, operational and social questions that arise under this heading are already receiving a great deal of official attention from several federal sources, including the Department of Finance, the Department of Justice, the Department of Communications, the Bank of Canada, the Law Reform Commission and the Canadian Payment System Standards Group. The end result of this activity, in which the banks are co-operating fully, will no doubt have a profound influence on the relationship between the banks and other organizations in the payments systems. It is impossible to foresee what developments will finally emerge, and with the attention the subject is already receiving we have not felt it necessary to explore it further here. On this of course we will be guided by the wishes of the Commission.

Securities Trading

110. An issue that the Commission might feel is of some interest to it relates to the role of the banks in trade in securities. We have dealt with this matter in our presentation to the Minister of Finance as follows:-

"Securities Trading

111. The banks, as a part of the financial services to their customers, buy and sell securities both as a

principal and as agent for clients. In thousands of municipalities across the country, banks are the only institutions through which Canadians can arrange transactions in securities. Furthermore, many customers in larger centres prefer to deal with their bank rather than with someone whose interest is primarily in selling.

For these and other reasons, dealing in securities has been and continues to be a normal function for a bank, which has been recognized by Parliament in successive revisions of the Bank Act.

Recent trends in provincial legislation have revealed the intention of provincial governments to assert control over chartered banks by requiring them and their employees to register as security dealers in order to engage in securities transactions. Such a requirement, if sustained as a matter of constitutional law, would give the provinces power to prevent the banks from dealing in securities, thus depriving a large number of Canadians of a valued service at a reasonable cost. In order to forestall such an eventuality the banks are seeking a more precise wording of Section 75, so that no doubt will arise as to their legal power to deal in securities and to participate in the distribution of new issues to the public."

THE ISSUES OF SIZE AND CONCENTRATION

General Statement

112. With regard to these issues, which are at the core of the Commission's enquiry, it is appropriate to point out that they were reviewed by the Royal Commission on Banking and Finance. In its report of 1964 the Commission commented on the dangers it saw, and recommended several changes in laws and regulations, most of which were implemented. The relevant passages of the Commission's "Final Assessment and Summary" (Report, pages 563-4) read as follows:-

> "There is a danger that competition can be weakened by collusion or excessive concentration of power. This is particularly the case with the banking institutions and we have therefore recommended in Chapter 18 that there be a prohibition on agreements between them with respect to lending and borrowing rates, and that this prohibition be supported by appropriate powers and penalties. We have also recommended that no banking institution may own more than 10% interest in the equity or voting shares of any non-financial firm and noted our disapproval of the practice of bank officers or employees serving as directors of commercial concerns. To prevent undue concentration in the banking and financial system we have recommended that no banking institution be allowed to acquire more than a 10% interest in the equity or voting shares of any non-bank financial institution. We have also made recommendations whose effect will be to maintain the present prohibition on one chartered bank investing in the stock of another and to prevent all other equity investments among banking institutions unless permission is first obtained from the Treasury Board (subject to an exception when two small institutions are involved). In addition, we have recommended that the Board be empowered to review any such acquisition in subsequent years and that it have power to order such remedy as is necessary to preserve competition in the public interest. We have also suggest-

> ed that there be statutory limits on interlocking directorates between banking institutions. Finally, we recommend that the anomaly in the present law, which prohibits share ownership of one Canadian bank by another but is silent on foreign bank ownership, be removed (although express provision should be made for the establishment of foreign bank agencies under the Bank Act). Such provisions, while not ruling out bank mergers or acquisitions which may enhance competition or project the public interest, will subject all sizeable transactions to prior scrutiny by the authorities and enable them to ensure that an excessive concentration of power does not develop".

113. As we have seen in the previous review of legal restrictions that apply to banks most of the major recommendations of the Commission were implemented in the Bank Act at the time of the 1967 revision.

114. Furthermore, as the Commission is aware, in the revisions of the Combines Act recently passed by Parliament and now awaiting Royal assent the banks were further brought under regulation in two major ways: (1) with the removal of the exception of services the banks were brought under the general provisions of the statute and (2) special amendments to the Bank Act were enacted which made illegal any inter-bank agreements on service charges (with minor exceptions), agreements on interest rates having been debarred by the 1967 revisions to the Act.

115. To sum up, we have the position in Canada that nearly every aspect of the banks as corporate entities is already closely governed by statute. Without undertaking a detailed study it is our impression that taken as a whole the current degree of regulation is as restrictive as any to be found in the world. No Canadian bank may merge with another Canadian bank without government permission; no Canadian bank may hold shares of another Canadian bank; there can be no common directors of banks; inter-locking directors with ordinary corporations are restricted; ownership of shares of other ordinary corporations is limited; there may be no inter-bank agreement on rates of interest or service charges; the provisions of the Combines Act relating to

to business practices apply to the banks as to other industries. One might well ask, therefore, what further steps could possibly be contemplated, and for what purpose?

116. The questions that are raised frequently in situations such as that found in Canadian banking relate to barriers to entry, competition among oligopolies or what is substantially the same thing, questions about market power of dominant firms.

Barriers To Entry

117. This is a caption that covers a multitude of advantages allegedly enjoyed by the firm already in existence over the new or proposed firm. These include the need for heavy initial capital outlays; start-up disadvantages in acquiring staff, management, systems, procedures, etc. and initial marketing and distribution problems, particularly where existing units have a long-established position. In the case of banks in Canada the list also includes delays in obtaining Parliamentary approval and the need to obtain entry into the clearing system operated by the existing chartered banks.

118. It can readily be conceded that in the general commercial world the firm that is already on the ground has advantages over the newcomer, with the very important qualification that it has not become moribund. The chances of this are not remote by any means, as experience shows from year to year. The rise and frequently the fall of firms is the breeding ground of the new businesses, and new businesses appear with re-assuring regularity. On the other hand if firms have survived in the rigours of a competitive market and remained a vital force in serving their customers the almost inevitable outcome is that they will grow in size and strength. The forces that have led to their survival are the same forces that lead to their future growth.

119. Of complaints about specific barriers to entry into Canadian banking it can be replied that the Parliamentary procedure does ensure that the responsibilities of operating a full-scale bank are not assumed lightly in this country; further they have been no problem to one bank already established in 1975 and do not appear to be discouraging another two that have applied for charters. Admission to the clearing system is not a problem, and is granted readily on sponsorship

of an existing bank; furthermore one of the proposals made by the Association to the Minister of Finance for revisions of the Bank Act in 1977 would permit direct entry of any institution to the system if it had a settlement account with the Bank of Canada. Establishment of a branch network on the scale of the existing banks does not now seem to be essential, and some of the most recent arrivals appear to be planning only limited branching. Indeed in the current outlook for technological development including access to bank computers from remote terminals it is by no means clear what role the branch will play in the future design of the banking system. Finally, the initial capital requirement of $1,000,000 has not seemed to present a problem. It has easily been exceeded several times over in subscriptions to shares of all the recent new chartered banks.

Competition Among Oligopolists

120. For purposes of the following discussion we have taken competition among oligopolists to mean a state in which a few large firms are in a position to dominate a market and that as a result their competition is of a different character than if there were many units competing in that market.

121. The principal problems alleged to arise from this condition in banking are:

1. That economies of scale are not sufficient in themselves to justify larger firms;
2. That competitive steps are taken by a firm in relative certainty of the reaction of the other firms in the business;
3. That the situation is exploited to maximize profits.

122. Before pursuing these ideas in relation to banking we must again remind the Commission that the apparent position of five chartered banks in holding nine-tenths of the assets of the banking system is deceptive. In fact if one-third of banking now is carried on by other organizations then the nine-tenths share drops to two-thirds of the total. Furthermore this aggregate measurement is misleading as to the position of the chartered banks in individual segments of the financial market. These segments have quite different character-

istics and the participation of the financial institutions in them varies widely. Segments in which the chartered banks would have a major position are commercial lending and to a somewhat lesser extent consumer finance. In the mortgage market the banks now underwrite about one-third of residential mortgages, a smaller proportion than that of the trust companies. Thus a comprehensive study would require an examination of individual segments of the financial market and the respective role of all the participants in each. We have not undertaken such a study but in dealing with aggregates have been fully aware that in important respects they are misleading.

Economies of Scale

123. One of the charges made against bigness in banking, mainly in academic literature, is that there is little evidence of economies of scale with increasing volume of operations.

124. In an appendix we reproduce a summary of the main U.S. studies and conclusion therefrom.* This was submitted by Professor Peter S. Rose, of the Finance Department of Texas A & M University, for publication in the Assocation's magazine, The Canadian Banker & ICB Review, and has appeared in the last issue. Professor Rose is a regular contributor to American banking periodicals as well as our own. The views he expresses in this piece are entirely his own.

125. The article itself is helpful, and we recommend it for study. For present purposes we reproduce his own summary:

What the Findings Mean

Economies of scale do exist in the commercial banking industry and, according to several recent studies, arise principally from the specialization of capital and labour made possible by large size banks. However, the results of bank cost studies must be interpreted with great care. For one thing, the convenience and needs of the customer are not considered. A banking system which provides many branch offices in convenient locations may be far more desirable from a social point of view than one which achieves a low

* available from CBA on request

level of operating costs but provides few customer benefits. Similarly, while large banks may have few cost advantages over small banks, the larger institutions usually offer a more complete line of services of better quality.

In a broader context, the cost studies suggest that small banks can survive in markets also served by large banks. The cost advantages of large banks are modest at best and probably insufficient to drive smaller banks from any market where they choose to compete aggressively. Regulators need have little fear that newly chartered banks can survive and prosper, provided, of course, that economic conditions remain favourable.

126. It is unfortunate that Canadian studies are not available, particularly because the scale of operations of most of the Canadian banks is larger than any of those studied in the United States. However we do not put much emphasis on the standard industrial approach to analysis of the subject because as Professor Rose points out there are other social and service considerations involved. Furthermore we are convinced that there are sufficient other advantages from size that it may be sufficient just to establish that there are not <u>diseconomies</u> of scale. On this point there seems to be no doubt, even from the results of the U.S. studies.

<u>Pricing Practices</u>

127. Another of the standard charges against oligopolists is that, while they may be fiercely competitive at all times, the competitive actions of any one firm will be taken with some general expectation of how the other firms will react. This is alleged to result in such practices as "price leadership", in which one firm independently arrives at a new price but shortly thereafter all other firms have also moved to that price. (For "price" one may substitute "service" or "product", since the principle in question is the same.)

Simply to lay at rest the issue of outright collusion among the banks through their Association we will dispose of this supposition right now.

Canadian Bankers' Association

128. The Canadian Bankers' Association is one of the oldest trade organizations in Canada. It was first formed on an unofficial basis in 1890, but was incorporated by act of the federal parliament in 1900.

It is interesting that while established mainly to serve the common needs of the banks in its earliest period it was also called upon to carry out some specific duties at the request of the federal government. For example the Association was required by government to supervise the printing, distribution and destruction of bank notes when they were issued by the chartered banks. In World War 1 the Association held the gold reserve of the country and acted for the government in other ways. There was discussion for a long time of the possibility of an Association bank inspection service. However, this idea terminated with the Home Bank failure in 1923 which precipitated the establishment of the office of the Inspector General of Banks.

129. Until the last decade the Association was the vehicle for inter-bank agreements on a variety of rates, charges and other service arrangements. A decade ago, for example, both lending and deposit interest rates were still set by agreement among the banks. There was no mystery about this as the fact was publicly admitted by bankers. Even more recently charges for services (cashing cheques, etc.) were being set on an agreed basis. (In many European countries agreed charges are still posted today in the banks in the name of the bankers' association of that country.) Also a decade ago there were inter-bank agreements on banking hours, advertising, staff raiding, and minor other matters.

130. Today all agreements of this sort are gone. Mainly they were undermined by the intense competition, both within the industry and from outside it, that followed the last Bank Act revision of 1967. The statutory prohibitions against agreements on interest rates and service charges were a factor, but were almost a factor that confirmed either an existing situation or one that was ready to break.

131. The one area where the Association is thought to exercise a monopoly position is in providing settlement

facilities for the three to four million cheques negotiated per day - the so-called clearing system. We have mentioned earlier in this connection that our proposals for the next revision of the Bank Act would permit non-banks to have access to the bank system. For that matter there is no legal impediment even now that prevents the non-bank institutions from setting up their own systems.

132. Today The Canadian Bankers' Association performs an essential function in an industry in which to an unusual degree the individual components must be closely integrated with one another in order to function at all. For example, the main instrument of the money system is still the cheque. In most banks two-thirds to three-quarters of the cheques handled in a day are cheques of other banks, and if they came in nine different sizes, shapes, location of data, etc. the results would be chaos. So there are agreements on technical details to overcome this problem. Similarly as banks move into the electronic age there will be common approaches to the preparation and transmission of data by this method to ensure uniformity. Purely for operating efficiency a good deal of co-operation of this sort between banks is absolutely essential.

133. In addition of course the Association carries on a great many other functions that are part of the usual services performed by a trade association for its industry. We are only dealing here with those that might be of interest to the Commission and which touch on the issue of competitive actions taken in uniformity.

<u>Uniformity of Response</u>

134. As to appearances of uniform actions among the banks in changing interest rates the reality is that the conditions within which such decisions are made largely apply in common to all banks and only to a limited extent are they within the control of an individual bank. A change in the general level of interest rates following a move in the Bank of Canada's discount rate or an alteration in the money supply as a result of actions of the monetary authorities will set general parameters within which an individual bank will have very little freedom to act in a way different from the other banks. In a very real sense, therefore, conditions of both supply and price are common constraints imposed on the banks

from the outside and their actions under changing influences therefore tend to be uniform. Perhaps the best illustration of this is that in the United States, with its 14,500 banks, a minor deviation from the general pattern by even a medium-sized bank is noted in the financial press. By the same token a move by one of the largest banks is read as forecasting a coming change throughout the whole banking system.

135. As to service charges it is true that in fundamental terms most banks are performing much the same functions for their customers under much the same conditions. As we said in our brief to the Royal Commission on Banking and Finance in 1963, (page 81):

> "The various banks offer a virtually identical range of services to the public, and no bank has a monopoly of staff and facilities capable of performing those services in a courteous and efficient manner. It is obvious that any bank will have to meet the best rate offered by other banks in any major category of service, otherwise it will lose virtually all its business in that line; there is therefore little scope for differences between banks in respect of interest rates or charges."

136. It is all the more significant therefore that in actual practice there is a good deal of variation in charges for services among the Canadian banks. The list of differences both in the charge and in the service being offered includes the following:-

1. retail customer "package" accounts;
2. Registered Retirement Savings Plans and Registered Home Ownership Savings Plans;
3. personal chequing account charges;
4. consumer lending rates;
5. current account charge calculation; (where individual customer characteristics are recognized)
6. regular savings, where there are differences in the number of free cheques allowed;
7. safekeeping charges;
8. automatic teller-type services

137. No doubt other differences could be added to this list, but it includes enough items to demonstrate that even where the basic functions being performed have much in common competitive forces will produce variations in charge.

138. One attitude regarding service charges that is generally held among Canadian bankers should be recorded at this point. Some elements of the deposit receiving system, such as the trust companies, operate chequing accounts without charge. This implies a deliberate choice to underwrite a fairly costly service as a loss leader for marketing purposes; in actuality it means that either the person receiving the service is paying for it indirectly in some other way or else it is being subsidized from some other service being provided by the firm and charged to other customers. The chartered banks have generally followed the approach that it was not equitable to subsidize one customer at the expense of another, and each service rendered therefore carries a charge which reflects the volume of use by each customer.

Profit Maximization

139. The third allegation that must be dealt with regarding oligopolists is that they act so as to maximize profit and are in a position to obtain greater profit than would otherwise be the case.

140. It is not clear as to just exactly what sort of study would be required to subject this issue to rigorous analysis in the case of the Canadian banks. If there is a condition of oligopoly it is one that has existed as we have said for at least half a century. For the greater part of that period the profits of the banks do not appear to have been an issue of public interest.

141. Whether or not profits of the distant past need study is a fairly academic question. We have not undertaken such a historical analysis and in any event it would not seem very fruitful for present purposes. We have looked in some detail at the situation of recent years, however, and are prepared to comment on it.

142. In examining this experience we have followed the pattern set by some of the official studies of

recent years - in particular the 1970 Report of the Prices and Incomes Commission on Chartered Bank Operations and Earnings under the Restraint Program and the 1971 Report by the same Commission on Bank Service Charges. In these reports the earnings of the banks were analysed in several ways to explain both their origin and their trends. We have adapted that analysis to the present time and added some further material to amplify this explanation.

143. In any analysis of bank profits the key considerations are dollar volume of activity and interest spreads, the former representing the base level of transactions and the latter the margin of profit. In the following pages we discuss recent experience under both these headings.

Effect of Increase in Dollar Volumes

144. We have emphasized earlier the central role of money supply as controlled by the monetary authorities in determining the size of the banking system. The same analysis holds true for the main influence in determining the "balance of revenue", the correct official term for before-tax profits. The report of the Prices and Incomes Commission stated, in reviewing experience to 1970, that "banking in Canada is a low-margin high-volume operation. --- Even if bank profits had risen merely in proportion to their asset volume, they would have shown a large increase over the period." This is the key to most of the increase in balance of revenues that has taken place since 1970 as well.

145. This fact is graphically demonstrated by a calculation which the Prices and Incomes Commission described in its April, 1971, Report as "The most widely-used measure of current performance of the chartered banks ---." (p.19). This measure is the annual balance of revenue for the year expressed as a percentage of annual average assets for the same year. It is the most comprehensive indicator of net results for the year that is available, reflecting as it does all factors, both domestic and foreign, that have affected the net result for the year.

146. In Table 6 below we set out a hypothetical calculation designed to illustrate the effect on the balance of revenue of changes in total assets. In order to do so we have assumed a condition in which the rate of return remained constant at the level of 1.10% in each year. This is not

the actual rate for any one year but can be regarded as close to a base rate for the period. All but two years (1967 and 1974) were in fact higher than this as the following series indicates: 1967 - .96%; 1968 - 1.18%; 1969 - 1.26%; 1970 - 1.22%; 1971 - 1.14%; 1972 - 1.18%; 1973 - 1.16%; 1974 - 1.04%. It is obvious from this series that a figure higher than 1.10% as the typical rate for the period would be justified. However the purpose is primarily to isolate the effect of changes in annual total assets by keeping rate of return constant and any figure that is within reasonable limits for rate of return will suffice. The results of this calculation are compared with actual results for each year in Table 6.

TABLE 6
Comparison of Actual Balance of Revenue with 1.10% Return on Average Total Assets

	Actual Balance of Revenue for Year (1) ($ mill.)	Average Total Assets ($ mill.)	Balance of Revenue at 1.10% of Total Assets ($ mill.)	Column 3 as % of Col. 1
	1	2	3	%
1967	275.7	28,791	316.7	114.9
1968	381.0	32,685	359.5	94.4
1969	485.6	38,554	424.1	87.3
1970	528.4	43,332	476.7	90.2
1971	557.0	48,648	535.1	96.1
1972	669.6	56,573	622.3	92.9
1973	778.9	67,089	738.0	94.7
1974	874.6	83,833	922.2	105.4

(1) Source - Bank of Canada Review, Table A4, February 1975.

147. A crucial fact emerges clearly from these figures. The annual level of profits of the chartered banks fro the years 1968 to 1974 can be almost totally accounted for by the growth in bank assets. And as we have demonstrated, this growth has been due to increases in the domestic money supply, to increases in foreign assets and to inflation. The effect of the better margins that could be earned following the Bank Act Revision of 1967 are apparent in the actual level of profits, but even the lower return of 1967 would have produced the same pattern of year to year

growth in later years given the same conditions of money supply, foreign currency assets and inflation.

148. This result must be viewed not only in the light of the fact that the size of the domestic banking system is largely under the control of the Bank of Canada but also that, as we have demonstrated, the banks' recent rate of growth has been no higher, and in some instances in fact has been lower, than other deposit-receiving financial institutions.

Interest Spreads

149. As we have said, the other major influence on balance of revenue is interest spreads. Receipts and outlays of interest are the two largest single components in the revenue and expense statements, and their role is therefore crucial in the final balance.

150. Refore looking at actual data, a word about the concept, "interest spread". Briefly, it is the difference between the cost of money and its yield. A common measure uses an average cost of funds calculated by expressing total interest paid in a year as a percentage of average total deposits of that year, and a yield of funds calculated as the interest received in a year expressed as a percentage of average loans of that year. A broader calculation includes interest on debentures in the cost and earnings on securities in the yield. Neither calculation includes operating costs or revenues associated with raising deposits, making loans, and rendering services.

151. The spread can widen or narrow with changes in interest paid on deposits (which in turn is influenced by the deposit mix) or with changes in the interest received on loans (which in turn is influenced by the mix of loans outstanding), or with changes in both.

152. Spreads do not increase automatically with higher interest rates. As Table 7 shows, spreads have varied within a narrow range in recent years, although interest rates have been at unprecedented levels. Changes in yield-cost relationships can occur at any level of interest rates, and can depend on the mix of yields and costs in each composite rate and the timing of changes in the main items as much as on general levels of interest rates.

153. In Table 7 we give the main cost and yield percentages and resulting spreads for years from 1967 to 1975. We also give in the same table Balance of Revenue as a percentage of average total assets for the year. This measure has already been introduced and is particularly significant in reflecting in a comprehensive way all factors affecting the final outcome for the year.

154. The comment in the immediately succeeding pages will be limited to the experience of the 1967-74 period. We have left for separate treatment the results of 1975, which have special characteristics and require more detailed analysis.

TABLE 7

Chartered Bank Annual Average Interest Spreads

(percentages)

	Average Interest Costs			Average Interest Yields			Spread between		Rates of Bal. of Revenue	Change from previous year
	Deposits	Debentures	Total	Loans	Securities	Total				
	1	2	3	4	5	6	(4-1)	(6-3)	7	8
1967	2.82	5.48	2.83	6.17	4.97	5.88	3.35	3.05	.96	+4.3
1968	3.44	6.72	3.45	6.99	5.65	6.66	3.55	3.21	1.17	+21.2
1969	4.34	6.75	4.35	8.09	6.00	7.63	3.75	3.28	1.25	+6.8
1970	5.15	6.75	5.16	8.89	6.51	8.41	3.74	3.25	1.22	-2.4
1971	4.16	6.96	4.17	7.77	5.79	7.34	3.61	3.17	1.14	-6.6
1972	3.69	7.25	3.70	7.20	5.60	6.88	3.51	3.18	1.18	+3.5
1973	4.61	7.39	4.63	8.31	5.92	7.91	3.70	3.28	1.16	-1.7
1974	6.82	7.30	6.83	10.60	7.01	10.09	3.78	3.26	1.04	-10.4
1975	6.07	7.74E	6.08	10.04	7.27	9.69	3.97	3.59	1.24	+19.2

1. Interest on Deposits divided by average total deposits.
2. Interest on debentures divided by average total debentures.
3. Interest on deposits and debentures divided by average total deposits and debentures.
4. Interest on loans divided by average total loans.
5. Earnings on securities divided by average total securities.
6. Interest on loans and earnings on securities divided by average total loans and securities.
7. Balalnce of Revenue as percentage of average total assets.
8. Percentage change from year to year in figures in previous column.

Three main observations can be made on the basis of these figures:-

155. Effect of 1967 Bank Act Revision - the change in both costs and yields in the years immediately following 1967 and the accompanying increase in spreads reflect the removal of the artificial restrictions imposed on the banks under the pre-1967 Bank Act.

156. The principal changes having this effect were the abandonment of the 6% interest ceiling, the granting of broadened mortgage powers and the reduction in Bank of Canada cash reserve requirements. These permitted the banks to increase their loans as a proportion of their assets and to make higher yielding loans for consumer financing, residential mortgages and term loans for businesses.

157. The former trend is reflected in the increase in loans from 66% of assets in 1967 to 76.6% in 1974, with a corresponding decline in investments. The latter is reflected in the increase in consumer and mortage loans in particular as factors in asset structure. In 1967 together they accounted for 18.5% of Canadian dollar assets and in 1974 for 26.6%. It is significant that in entering these new areas of lending while the banks were able to improve their own return they generally were also able to reduce costs to borrowers by reason of their competition.

158. Relative Stability of Spreads - as measured on either basis - "deposit cost to loan yield" or "total interest costs to total interest yields" - interest spreads were remarkably stable for the period 1969 to 1974 once the initial effect of the Bank Act changes had become established. In four of these six years spreads moved in such a narrow range that they could be said almost not to have changed. The two years that showed the greatest variation, 1971 and 1972, were unusual in the extent to which they moved away from the pattern.

159. Decline in Rates of Balance of Revenue - the other most notable feature is that return on assets showed a moderate downward trend during the period 1969 to 1974. As demonstrated by the figures in Table 9, even the rise in 1975 represented mainly an improvement in return on international business with return on domestic assets remaining at the level of several recent years. We

discuss this point in detail later.

160. The sharp 1974 decline deserves explanation, as it has provided the low base against which 1975 profit increases are being measured. It resulted from a drop in the ratio of earnings to assets of the three largest banks and a particularly large decline for one of them. These were only partly offset by small increases in two of the other banks. This can be illustrated by the following figures, which give first the 1973 ratio and second the ratio for 1974, for the five largest banks:- Royal - 1.18: 1.04; Commerce - 1.26: 1.18; Montreal - 1.04: .67; Nova Scotia - 1.15: 1.19; Toronto Dominion - 1.21: 1.28.

Operating Costs and Balance of Revenue

161. The effect of increasing operating costs on reducing the balance of revenue can be illustrated through published data. In the analysis of the main categories of revenues and expenditures made by the Bank of Canada and published in the February issue of its Review sufficient detail is given to demonstrate the point.

162. In the following table "Other Operating Income" which is all income other than return on loans and securities, is compared with expenses other than interest on deposits and debentures. By far the largest of these expenses are for staff - salaries, pension contributions and staff benefits, and the other headings are property expenses and other operating expenses.

163. It should be emphasized that this comparison is not made on a cost accounting basis, since in fact much of the staff time is devoted to the making of loans and the receiving of deposits, and on a full costing basis would be introduced into the spread calculations. However, the spreads have been calculated to take account only of interest costs and interest yields, and the purpose of the figures given below is solely to demonstrate the behaviour of revenues and expenses outside the spread calculations.

TABLE 8
Comparison of Non-Interest Operating Revenues and Expenses - 1969 to 1974

	Operating Income	Operating Expense	Ratio of Income to Expense
	($ mill.)	($ mill.)	%
1967	237.1	698.1	34.0
1968	271.7	796.5	34.1
1969	311.8	915.1	34.1
1970	333.9	1020.3	32.7
1971	339.4	1123.4	30.2
1972	384.8	1271.0	30.3
1973	449.5	1561.7	28.8
1974	543.5	1959.6	27.7

164. The above comparison serves to demonstrate that the relationship of expenses and revenues outside the interest cost and yield calculation have had a definite bearing on the balance of revenue in the last five years. The relatively more rapid rise of expenses shows up clearly in the decline in the relationship of revenues to outlays and no doubt accounts for the declining trend in the balance of revenue to assets ratio in recent years.

165. Inflation has undoubtedly had an impact on bank revenues and costs, but it is difficult to isolate because so many other conditions have changed at the same time. A rigorous analysis would require an econometric study that would reconstruct the elements of revenue and expense as they would have been in the absence of inflation, a large and fairly hypothetical undertaking.

166. At a very unsophisticated level we can offer the comment that if the G.N.E. price deflator is applied to the balance of revenue of 1974, when inflation had become a major factor, it would have been reduced by $120 million, or about 14%. This calculation makes many assumptions that might not stand rigorous analysis, but does suggest that inflation must be a factor of some importance in the actual magnitude of recent balance of revenue figures.

Foreign Currency Business in the Balance of Revenue

167. Earlier it was mentioned that all the data then being presented related to the aggregate of the Canadian

dollar and foreign currency business of the banks. In fact nearly 30% of bank assets are held in foreign currencies, and returns from this business make a very substantial contribution to the total profits reported by the Canadian banks. The development of this business not only represents one of the most innovative steps taken by any Canadian industry in the foreign area but by improving our overall financial strength enables the banks to better serve Canadian businesses and help Canada's trade balance.

168. Information on the operating results of this foreign business has not been prepared on an industry basis in the past but for this presentation a special compilation has been made. In the short time since financial results became available for the bank years, which closed on October 31st, we have assembled the best information that could be readily obtained from the five largest banks, which account for nearly all this business.

169. We are now able to present information on both assets and balance of revenue for the years 1970 to 1975, with an allocation of both between domestic and international business. The results of this compilation are given in Table 9. (Since these figures relate only to the five large banks ratios are slightly different than those previously given.)

TABLE 9

DOMESTIC AND INTERNATIONAL BUSINESS
FIVE LARGEST BANKS
ASSETS AND BALANCE OF REVENUE – 1970-75

	Assets (1) ($ mill.)			Balance of Revenue (2) ($ mill.)			Ratios: Bal. of Rev. to all Assets			Ratios: % of Total Assets		Ratios: % of Bal. of Rev.	
	Dom.	Int.	Tot.	Dom.	Int.	Tot.	Dom %	Int. %	Tot. %	Dom. %	Int. %	Dom. %	Int. %
1970	28,616	11,667	40,283	414.8	77.4	492.2	1.45	.66	1.22	71.0	29.0	84.3	15.7
1971	32,354	12,654	45,008	418.4	98.1	516.5	1.29	.78	1.15	71.9	28.1	81.0	19.0
1972	38,174	13,724	51,898	515.2	110.0	625.2	1.35	.80	1.20	73.6	26.4	82.4	17.6
1973	44,189	17,175	61,364	592.1	124.2	716.3	1.34	.72	1.17	72.0	28.0	82.6	17.4
1974	53,176	23,474	76,651	628.6	174.7	803.3	1.18	.74	1.05	69.4	30.6	78.2	21.8
1975	63,330	27,102	90,432	851.8	284.1	1.135.9	1.35	1.05	1.26	70.0	30.0	75.0	25.0

(1) Average monthly assets calculated on a 13 month-end basis.

(2) As at October 31,

170. One striking result emerges from these figures - while the ratio of international assets to total assets has remained fairly constant in this period at 28 - 30%, there has been an increase from 15.7% in 1970 to 25% in 1975 in the share of balance of revenue accounted for by the international side. The most dramatic change has taken place in the last two years, and has been attributable to improved wholesale margins in the Euro-dollar market, where the Canadian banks were among the first and most successful participants, and also to the increasing proportion of foreign currency assets represented by business and other loans. At the beginning of 1974 the proportion of international assets in this form was around 30%; it moved up to 40% a year ago and has continued to increase throughout 1975, with the prospect that the ratio will soon exceed 50%. Spreads on this type of business are much higher than on "wholesale" financing.

We will make further comment on this domestic-international compilation in the following review of results for 1975.

The Results for 1975

171. Because in many respects 1975 has been an exceptional year in the operations of the banks we have left it for special comment. There is the additional circumstance that final results for the last year only became available in the last stages of preparation of this brief, as bank fiscal years end on October 31.

172. Our analysis follows the lines we have adopted previously, with main attention paid to the effect of increases in volume, trends in interest spreads and the impact on balance of revenue of rising operating costs. Throughout we have given figures for 1973 and 1974 for comparison.

1. Increases in Volume

173. Both Canadian dollar and foreign currency assets continued to rise during the year. For comparability the position at October 31st is given below for 1975 and the previous two years.

	Average Interest Costs			Average Interest Yields			Spread between		Rates of Balance of Revenue	Change from Previous Year
	Deposits	Debentures	Total	Loans	Securities	Total	(4-1)	(6-3)		
	1	2	3	4	5	6			7	8
1973	4.61	7.39	4.63	8.31	5.92	7.91	3.70	3.28	1.16	- 1.7
1974	6.82	7.30	6.83	10.60	7.01	10.09	3.78	3.26	1.04	-10.4
1975	6.07	7.74E	6.08	10.04	7.27	9.67	3.97	3.59	1.24	+19.2

(all concepts are as explained in previous table)

October 31	Canadian Dollar Assets	Foreign Currency Assets	Total
	($ mill.)	($ mill.)	($ mill.)
1973 (1)	53,303	21,718	75,021
1974 (1)	65,096	26,496	91,592
1975 (2)	74,539	30,772	105,311

(1) Bank of Canada Review, Table 7
(2) Estimated by C.B.A.

174. Canadian Dollar Assets: an increase in domestic money supply at annual rates exceeding 15% (depending on the definition used) for most of the period since last October explains the growth of 14.5%

175. Foreign Currency Assets: rose more rapidly than Canadian dollar assets, the increase being 16.1% between year ends.

Hypothetical Return on Assets

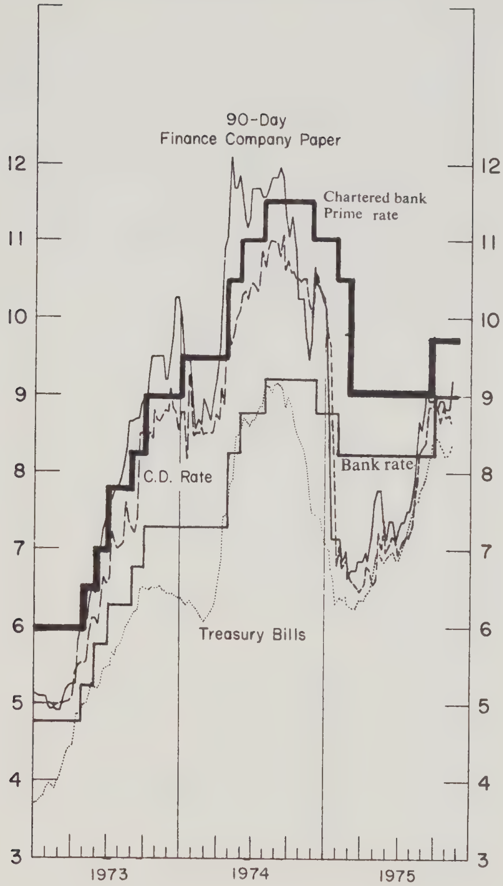
176. Applying the previously used rate of return of 1.10% on average total assets for 1975 would give a Balance of Revenue of $1,093 millions. This compares with an actual total of $1,234 millions for the year.

177. As for several years past a substantial part of the increase in Balance of Revenue for 1975 is attributable to the rise in asset holdings. It is also evident however that a greater share of the increase was attributable to other factors in 1975.

2. Interest Spreads

178. The analysis of interest spreads shown previously is given below for the years 1973 to 1975 (all figures are percentages)

SELECTED INTEREST RATES
Per Cent - Wednesdays



Bank of Canada Chart with Prime Rate
and Bank Rate added by C.B.A.

Factors affecting the 1975 Domestic Spreads

179. It is evident that the relative stability of interest spreads in the last two years was disrupted in 1975. A variety of factors, most of them unexpected, account for this development. It is not possible to give accurate weight to their influence on the final outcome, but some were obviously of greater importance than others.

180. Prime Rate vs Costs in Money Market - undoubtedly on the domestic side a factor was the gap that developed for much of the year between the cost of "bought funds" and the prime rate. As shown on the graph on the following page, money market rates dropped gradually in late 1974 and fell precipitously in January, 1975, to a level 40-50% below the peak of 1974. Bank Rate and Prime Rate both declined in reflection of the downward trend, but not to the same degree. It would not be normal for either to change in parallel with such a drastic turn-around, and there was no doubt an assumption by both the central bank and the chartered banks that the decline was too sharp to last beyond a short period, whereas in fact it continued for some months. During this period the central bank maintained interest rates at a relatively stable level for reasons of general monetary policy, and the chartered banks followed this lead. Obviously, this judgment, because it assumed a temporary situation, contributed to a widening of domestic spreads for a part of the year.

181. Reduction in secondary reserve - the reduction in the secondary reserve requirement by successive decreases from a level of 8% in November, 1974 to 5½% in March, 1975, released nearly one billion dollars for lending at higher rates of return than the yield on treasury bills. The result of this has also been a further increase in the ratio of loans to total assets.

182. Other domestic factors - also contributing to the wider spreads were the level of interest rates in the mortgage market and the continuing high demand for consumer loans.

183. The Domestic Balance of Revenue - the effect of the factors just mentioned is shown in the increase from 1.18% in 1974 to 1.35% in 1975 in the ratio of domestic balance of revenue to domestic assets (see

previous table). It is clear however that this is not an accurate reflection of the recent trend of profits because 1974 is an exceptionally low year for comparison purposes. The return of 1.35% in 1975 is more fairly compared with 1.35% for 1972 and 1.34% for 1973. In fact if 1974 is omitted from the calculation the average for all the years 1970 to 1975 is 1.35%.

184. On the domestic side of the banks' business the year 1975 can be said to have shown no greater return than typical results of the last five years. Had 1974 shown the same earnings ratio (1.35%), the percentage increase in domestic profits would have been half the 35% increase otherwise indicated for 1975.

185. <u>International Balance of Revenue</u> - in view of the return of earnings on domestic assets to a relatively normal level, the increase in the rate on foreign assets from .74% to 1.05% is the remarkable feature of 1975. This was an increase of 40% from the previous year which in this case was about an average year. The comparison therefore is realistic.

186. The two main factors that explain this increase have already been mentioned - the better margins on Euro-dollar "wholesale" transactions and the increasing share of loans among foreign currency assets. Together they have brought return on international assets from a level of .66% in 1970 to 1.05% in 1975, resulting in an increase in the share of the total from 15.7% in 1970 to 21.8% 1974 and 25% in 1975. With no increase in the share of total assets, international profts rose by 62% compared with 35% for domestic profits.

187. In addition to the tables already given, some of the key information on trends in international and domestic assets and profits are shown on the accompanying charts.

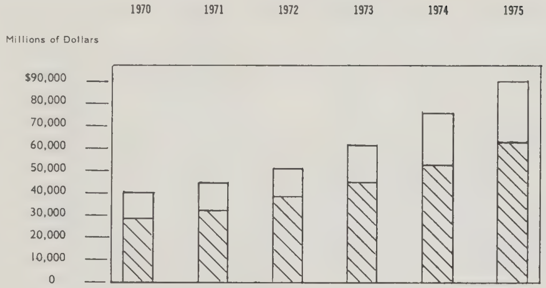
<u>Precautionary Observations</u>

188. Before concluding this survey of bank profits, we should clarify and emphasize two aspects of the presentation so that there is no danger of misunderstanding.

<u>189</u>. <u>All Calculations are Pre-Tax</u>: Although it has been indicated in the text it should be repeated that all calculations for balance of revenue, interest

DOMESTIC AND INTERNATIONAL BUSINESS FIVE LARGEST BANKS

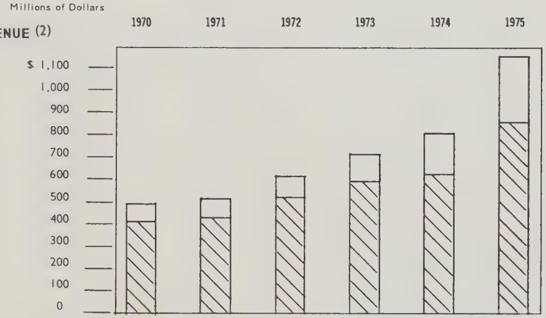
ASSETS (1)



(1) AVERAGE MONTHLY ASSETS CALCULATED ON A 13 MONTH-END BASIS:

	1970	1971	1972	1973	1974	1975
International	$11,667	$12,654	$13,724	$17,175	$23,474	$27,102
Domestic	28,616	32,354	38,174	44,189	53,177	63,330
TOTAL ASSETS	$40,283	$45,008	$51,898	$61,364	$76,651	$90,432

BALANCE OF REVENUE (2)

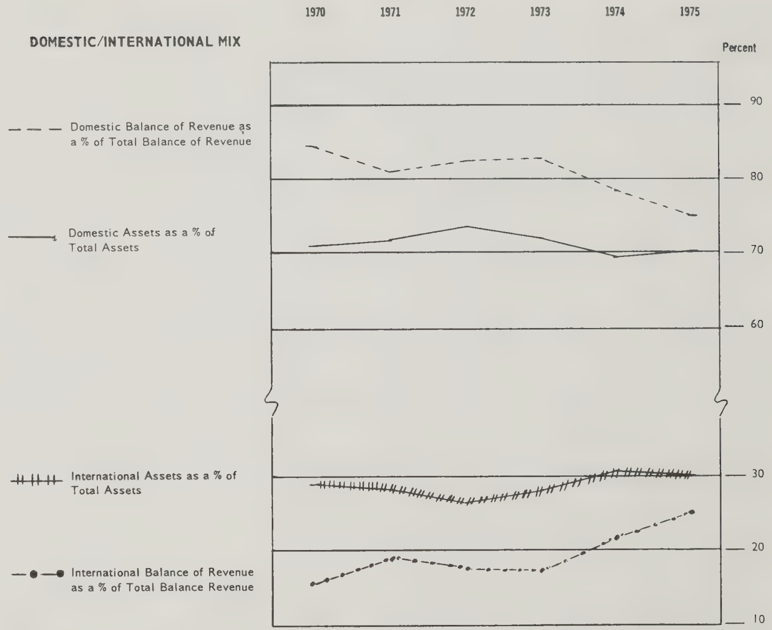


(2) BALANCE OF REVENUE BEFORE PROVISION FOR INCOME TAXES, FOR FISCAL YEARS ENDED OCTOBER 31:

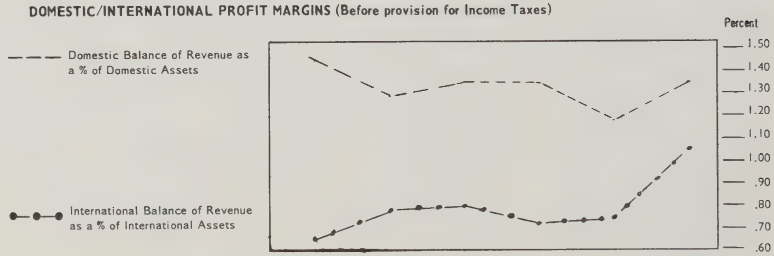
	1970	1971	1972	1973	1974	1975
International	$ 77.4	$ 98.1	$110.0	$124.2	$174.7	$284.1
Domestic	414.8	418.4	515.2	592.1	628.6	851.8
TOTAL BALANCE OF REVENUE	$492.2	$516.5	$625.2	$716.3	$803.3	$1135.9

DOMESTIC AND INTERNATIONAL BUSINESS FIVE LARGEST BANKS (Cont'd)

DOMESTIC/INTERNATIONAL MIX



DOMESTIC/INTERNATIONAL PROFIT MARGINS (Before provision for Income Taxes)



Charts Prepared by The Canadian Bankers' Association

spreads, etc. presented in this survey are before-tax figures. The banks are subject to corporate income tax at full rates, since as service corporations they do not qualify for the reduced rates that have been extended to manufacturing and industrial corporations in recent years.

190. In some of the individual bank submissions to the Commission, more attention is paid to tax and related factors such as provision for loan losses. We have been concerned in this presentation to trace the broad movement of elements in the pre-tax profit computation.

191. Rates of Return on Capital: We have not presented data for rates of return on capital because we understand that this subject will also be covered in briefs from individual banks. Nor for the same reason have we presented the arguments in support of profit and a reasonable return for shareholders as an essential condition for maintaining the capital base required for the viable operation of a bank. In this respect a bank is much like any other corporation except that with growth as rapid as that of recent years, the maintenance of a proper relationship between shareholders' equity and corporate liabilities has been extremely difficult.

SUMMING UP - COMPETITION

192. Economies of scale do arise in larger banking institutions according to U.S. studies, but these may not reflect the position in banks as large as the main Canadian banks. We are convinced that such economies do exist and will be more important with increasing use of automated equipment.

193. The principal conditions of price competition in the banking system are mainly outside the control of the individual banks, their major move, a change in interest rates, being largely determined by market forces and particularly by central bank monetary policy. Even in a highly diversified system such as the American, changes in rates tend to take place almost simultaneously once a trend has been established.

194. The recent profits of the Canadian banking system have resulted principally from the very marked increase in their assets due to growth in the money supply,

foreign currency transactions, increased economic activity and inflation. There has been very little change in interest spreads in recent years, although the results for 1975 were unusual, and have been explained. While the banks attempt to obtain the best possible profit for their shareholders we submit that there is no evidence that they abuse their position in order to do so.

CONCLUSION - THE ISSUES FACING THE COMMISSION

195. In the foregoing we have dealt with a fairly familiar list of economic questions that arise from size and concentration of power in the corporate structure. In doing so we have looked particularly at aspects of the Canadian banking system. Whether the Canadian banks are of a size to warrant concern and whether they represent a concentration of power that is contrary to the public interest will be for the Commission to consider. We believe we have presented enough evidence that the Commission will be able to give the question a thorough and well-informed review.

Two things are left to be said.

196. First, it seems that in dealing with the Commission's general assignment the economic issues come easily to the fore, whereas the social aspects are a good deal more elusive. Obviously, we are confronting an aspect of the business equation which, although not entirely new, has not yet reached the point of being automatically embodied in the decisions of all firms. Some of these, which fit readily into the normal business scheme of things because they involve familiar problems of technology, (e.g. effects on the environment), have already passed the initiation. Under uniform requirements provided by statute and financial assistance from government they will work themselves out over the long-range future. Physical problems tend to be more manageable in any event once the economics of compliance are clear.

197. As we read it the Commission's assignment is not to consider all the social implications of the corporate existence nor for that matter even the response of large corporations to a list of "social issues", whatever that list might contain. There is

no _a priori_ evidence that large corporations have reacted less constructively than medium or small corporations to such a list - indeed it is very likely that they have been leaders. The precise and very challenging issue facing the Commission, as we interpret it, is to determine, _per se_, the social implications of size and concentration of corporate power.

198. The existence of "big" corporations (just as the existence of big government and big unions) certainly has implications for social structure, social organization and social dynamics. If only because the economic force is probably the most dominant in society and the large corporation is its most conspicuous and effective instrument there must be social implications of great importance. What are the implications for the distribution of power and equally of responsibility in society? What are the results for income distribution or wealth holdings? How far do large corporations set patterns for our life-style and then merchandise them by every means available (the J.K. Galbraith "Industrial State" hypothesis)? To what extent is the profit motive the only influence that governs the actions of large corporations? Are they sufficiently responsive to new trends, generally embraced in the term "consumerism"? Are their boards of directors representative of all the interests that should have an impact at the policy-making level of the large corporation? Are their shareholders well enough informed to take an intelligent interest in the affairs of the corporation? This is not an unfamiliar list of questions, and can be extended to include many others.

199. Perhaps the basic dilemma the Commission will face is one that economists have generally ignored in the past but which is now emerging fairly clearly. This is the ironical truth that economic and social rationality are frequently incompatible. The solution that is exactly right for one area is often precisely wrong for the other. There are so many instances of this in our modern society that in total they represent a daily challenge for policy-makers. To illustrate: the relief of distress and poverty through income redistribution is a social measure that receives almost unanimous support; but when it appears that the result may have been to stimulate consumption rather than saving and to reduce economic incentives grave doubts are expressed as to the wisdom of specific programs.

Compromise between these objectives has been necessary, and no doubt the Commission will find itself facing similar situations.

200. The second and concluding point we wish to make is that we would not profess that bigness is always best or that it is even better under all conditions. There are many needs that can be well served by the individual, the partnership or the small firm. But this does not contradict in any way the fact that the industrial, commercial and financial worlds are now the battleground of giants. This is especially true of the world of international competition, in which Canada must hold a strong position in order to survive as one of the leading trading nations of the world. Even banks of the size of the Canadian must frequently form consortia in order to compete with large banks from other countries in making large international loans. The chartered banking system is a constant and unique strength which has aided the nation in many times of stress and is serving it well today. The fact that it is composed of units that have access to great resources of funds, talent and experience has contributed immeasurably to this result.

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